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DECEMBER
MONTHLY COMMENTARY

2022 was a year that was plagued by high inflation, the war in Ukraine, further COVID-19 related lockdowns and painful central bank interest rate hikes. It offered investors limited places to hide, and as such, for many it may be a year they would prefer to forget. For bond investors, this year goes on record as the worse year since inception for the Barclay's Global Aggregate Bond Index, which was down about 16.3% for the year. Equity markets brought no relief either with major equity indexes finishing the year in the red: S&P 500 -18.1%, Euro Stoxx 50 -8.6%, MSCI World -17.7%, MSCI EM -19.7%. The energy sector was perhaps the only exception (other than the US dollar) which had its best year on record closing at 47.8%.
December offered little in the way of an uplifting close for markets with no sign of a Santa Claus rally. The key events of the month were focussed on inflation data and the final actions in 2022 made by central banks globally.

UNITED KINGDOM

In the UK, inflation edged lower for November with consumer prices up 10.7% annually in November in contrast to October's 11.1%. The deceleration was attributed to falling energy prices and declines in used car prices. However, the good news was moderated by further acceleration in food prices. Overall, the stubbornly high inflation paired with much lower wage inflation continues to weigh heavy on households and purchasing power in the UK. Consequently, an expected further rate hike of 0.50% to 3.5% was implemented by the Bank of England on 15th December 2022. Although bringing inflation down is a key goal, controlling the people's perception of future inflation is also seen as critical to reduce wage increases because employers will buckle under the mounting pressure.

EUROZONE

In the Eurozone, investors were surprised by hawkish action from the European Central Bank (ECB) which raised its benchmark rate by an additional 0.50% in December. With the energy crisis being blamed for most of the inflationary pressures in Europe, many have called for the ECB to pause on hikes as further tightening may only serve to stifle growth without easing inflation. However, the stance was clearly delivered by ECB President Christine Lagarde who said that "the ECB is not pivoting." And they didn't stop there. Further tightening plans were laid out which involve reducing the size of the ECB's balance sheet by allowing bonds to mature without reinvestment or selling down. This could lead to sharp rises in bond yields and spreads. Although these further steps are being taken to dampen inflation, the figures for November showed that prices were beginning to decelerate, however, it is too early to commit that it is a trend. The EU reported that, annually, consumer prices were up 10.1% in November which was lower than October's 10.6%. Core prices, however, stayed at the October levels of 5% on the previous year.

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UNITED STATES

Inflation in the US is continuing its deceleration since June's peak. Declining energy prices plays a large role in this, of course, but even core inflation (which excludes food and energy) is starting to decelerate; only up 6% from a year earlier compared to the peak in September of 6.6%. Improvements in supply chain efficiency are clearly playing a key role as evidenced by the welcomed annual price declines of 3.3% for used cars which were affected by semiconductor shortages that are now abating. This is a victory in the inflation battle when you consider that the prices of used cars were up more than 41% annually in February of 2022, making up a large share of total inflation at the time. The improved inflation data was welcomed by investors as lower inflation moving forward demands less rate hiking action from the Federal Reserve, which in turn boosts growth in the US, a soft landing if you will.

Although the perception on the speed of future fed rate hikes seems to have shifted, the rate increase in December was largely as expected with market participants giving an 80% probability of the 0.50% move before the announcement. And while further rate increases are expected, the improved inflation picture gives the fed more confidence that their policy will bring inflation under control.

In addition to the UK, Eurozone and the US, other central banks followed in increasing their rates by 0.50%: Denmark, Switzerland, Philippines and Mexico.

CHINA

China took major steps to relax its COVID-19 restrictions in December in a likely bid to boost economic activity, which has been suppressed by repeated lockdowns throughout the year. Furthermore, unfavourable data for retail sales which were down 6% and muted industrial production of only 2.2% in November from the previous year plus the troubles in the residential property market clearly forced the government to blink on its strict COVID-19 policy. In addition, further steps will be taken to open the economy and boost domestic demand to protect themselves internationally by increasing other countries dependency. Market participants will be watching the economic data closely as China emerges from the initial waves of infections in 2023 to determine whether the loosening of restrictions have had positive impact on growth going forward.